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Before the
Federal Communications Commission
Washington, DC 20544

In The Matter of	)	
	)	
2000 Biennial Regulatory Review	)	CC Docket No. 00-175
Separate Affiliate Requirement of	)	
Section 64.1903 of the	)	
Commission's Rules	)	

COMMENTS OF VALOR TELECOMMUNICATIONS ENTERPRISES, L.L.C.

by

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Summary

Valor Telecommunications Enterprises, a non-BOC-owned (i.e., "independent") ILEC, asks the Commission in these comments to reject any proposal that would apply to independent ILECs the requirements set forth in Section 272 of the Act . That section describes the structural separation that is required when BOC-owned ILECs provide both exchange and interexchange service in their exchange service territory. In fact, Valor urges the agency to repeal Section 64.1903 of the Rules, which establishes structural separations requirements for independent ILECs that provide exchange and interexchange service that are less stringent than the BOC requirements in Section 272.

On the question of whether to apply the BOC separations requirements to independent ILECs, Valor shows that applying these requirements to independent ILECs would be inconsistent with each of the four reasons that the FCC gave in 1997 for not doing so. At that time, the FCC held that the BOC separations requirements are not warranted because independent ILECs are less likely than BOC ILECs to successfully engage in predatory conduct against interexchange competitors given that (i) the exchange territory of independent ILECs as a group is more widely dispersed than the exchange territory of BOC ILECs; (ii) the exchange territory of independent ILECs as a group is more rural than the exchange territory of BOC ILECs; (iii) the percentage of independent ILEC interexchange calls that terminate within the originating ILECs' exchange area is smaller than the percentage of BOC ILEC interexchange calls that terminate within the BOC ILECs' exchange area; and (iv) there had been few documented complaints that independent ILEC exchange carriers had engaged in predatory behavior against their interexchange competitors. Valor shows in its comments that each of these four facts is even more true today than in 1997.

Valor makes three arguments to support its request that the FCC repeal Section 64.1903. First, failing to repeal this Rule would be inconsistent with action that the FCC has taken in a parallel situation. Specifically, shortly after adopting Rule 64.1903, the Commission adopted a substantially identical rule governing the provision by ILECs of exchange and CMRS. But since the exchange/CMRS rule expires on January 1, 2002 because of the FCC's finding that it is not warranted after that date, the Commission must also repeal Rule 64.1903 since it adopted that Rule for the same reasons that it had adopted the CMRS rule. Second, several recent changes in FCC regulatory policy have reduced the need for Rule 64.1903. Third, the rule has a more substantial negative effect on interexchange competition today than when it was adopted due to changes in the interexchange market.

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COMMENTS OF VALOR TELECOMMUNICATIONS ENTERPRISES, L.L.C.

Valor Telecommunications Enterprises, L.L.C. submits these comments in response to the Commission's request for suggestions on modifying Section 64.1903 of the Rules.[1] That Rule regulates the manner in which non-BOC-owned incumbent local exchange carriers ("independent ILECs") may provide interexchange service to their exchange service customers ("in-region" interexchange service). It does so by requiring that independent ILECs structurally separate their exchange and interexchange operations in specified ways. In its comments, Valor, an independent ILEC, explains why the Commission should reject any proposal to increase the separations requirements set forth in Section 64.1903. Valor also explains why USTA's proposal to eliminate Rule 64.1903 should be implemented.

BACKGROUND

A. Valor and Its Business Operations

Valor is a mid-sized independent ILEC providing exchange service over more than 550,000 loops in about 250 small and widely dispersed communities in Oklahoma, New Mexico, Texas, and Arkansas. Valor purchased its exchange operations in these states from GTE last year. Valor's Texas, Arkansas and New Mexico operations (425,000 loops) are

[1] *See* 66 Fed. Reg. 50139, Oct. 2, 2001. The rules are printed at 47 C.F. §§ 64.1901-1903.

deemed "rural" exchanges under Section 3(37) of the Communications Act.[2] The company's interstate access service prices for all states are regulated under the FCC's price cap rules.

While Section 251(f) of the Act exempts "rural" ILECs from the obligation to facilitate local exchange competition by complying with the interconnection, collocation and network element unbundling requirements set forth in Section 251(c), Valor has committed to the state public utility commissions in Texas and New Mexico that it would not invoke the "rural" exemption. Indeed, Valor has interconnection agreements with several exchange competitors, and it faces exchange competition in a number of exchanges, including small and rural exchanges.

Valor does not provide interexchange service to customers located outside of its exchange territory, but it began offering interexchange service throughout its exchange territory in February 2001. At present, Valor provides in-region interexchange service to more than 55,000 loops, giving it a 10 percent share of the interexchange market within its exchange territory. The company provides interexchange service solely as a reseller. Valor's interexchange offerings compete with interexchange offerings by AT&T, WorldCom, and Sprint, each of whom provides interexchange service throughout the Valor exchange territory.

B. Separations Requirements Applicable to ILEC Provision of Exchange Service and In-Region Interexchange Service

Telecommunications policy requires all ILECs to operate their exchange and in-region interexchange businesses separately. But the level of separation that is required for independent ILECs is different from the level of separation that is required for BOC-owned ILECs as summarized below.

[2] Valor's Arkansas customers, all of whom are served from one exchange located in Texas, are part of the company's Texas study area. Valor's Oklahoma exchange operation is not "rural" because more than 15 percent of the company's loops in its Oklahoma study area are in communities of more than 50,000 population. Under Section 3(37) of the Act, an ILEC is "rural" in a given study area only if fewer than 15 percent of its loops in that study area are in communities with of population of more than 50,000. Thirty-six of the 37 communities in Valor's Oklahoma study area have a population of less than 50,000. Thirty have a population of less than 5,000.

1. <u>Separations Requirements Applicable to Independent ILECs</u>

In 1997, the FCC adopted a rule requiring an independent ILEC to separate its exchange and in-region interexchange operations in three ways. First, the ILEC was required to provide exchange service and interexchange service through separate corporate entities, and these entities were barred from jointly owning any transmission or switching equipment. Second, the ILEC was required to keep separate books of account for its exchange and interexchange services. Finally, the ILEC's interexchange business was required to purchase any exchange services obtained from its exchange affiliate under terms set by the exchange affiliate's tariff.[3]

On reconsideration in 1998, the Commission reaffirmed that the three requirements adopted a year earlier should apply to an independent ILEC that provides in-region interexchange service on a <u>facilities-basis</u>. But the agency repealed the requirement that an independent ILEC provide exchange and in-region interexchange service through separate entities when the ILEC provides interexchange service on a <u>resale</u> basis. Instead, the Commission held that independent ILECs could provide exchange service and in-region resale interexchange service through different divisions of a single entity.[4] Separations requirements applicable to independent ILEC provision of exchange and interexchange service are codified in Section 64.1903 of the Rules.

2. <u>Separations Requirements Applicable to BOC-Owned ILECs</u>

Separations requirements applicable to the exchange and in-region interchange operations of an independent ILEC are less stringent than the separations requirements that apply to the in-region interchange business of a BOC-owned ILEC. Not only must a BOC-ILEC provide exchange service and in-region interexchange service (both facilities-based and resale)

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[3] *LEC Classification Order*, 12 FCC Rcd. 15756 (1997), *First Order on Recon.*, 12 FCC Rcd. 8730 (1997).

[4] *LEC Classification Order, Second Order on Reconsideration,* 16 Comm. Reg. (P&F) 507 (1998).

through separate entities, Section 272 of the Act also imposes several restrictions on the manner in which the BOC's exchange and interexchange affiliates may interact with each other that do not apply to an independent ILEC's exchange and interexchange affiliates.[5]

DISCUSSION

In Part I below, we show that there is no basis for imposing on independent ILECs the more stringent exchange/interexchange separations requirements applicable to BOC-ILECs as some have suggested. In fact, we show in Part II that the public interest now requires that the Commission repeal Section 64.1903 of the Rules. Repealing that Rule would permit an independent ILEC to provide exchange service and in-region facilities-based interexchange service subject to the numerous safeguards contained elsewhere in the Communications Act and in the FCC's Rules.

I. Previous FCC Findings Preclude the Agency from Requiring Independent ILECs To Provide Interexchange Service Under Structural Separations Rules Applicable to BOC-ILECs

The Commission should reject any proposal to impose on an independent ILEC that provides in-region interexchange service the more stringent separations requirements that apply to a BOC-owned ILEC that provides in-region interexchange service since the four reasons given by the FCC for rejecting such proposals in 1997 provide an even stronger basis for rejection today. The first factor that caused the FCC to reject such proposals was its finding that an independent ILEC is less likely than a BOC-ILEC to engage in predatory behavior against its in-region interexchange competitors because the exchange areas of independent ILECs as a group are more widely dispersed than the exchange areas of BOC-ILECs.[6] Today, the exchange areas of independent ILECs as a group are even <u>more</u> widely dispersed than those of BOC-owned ILECs since BOCs and other large ILECs have sold hundreds of their smallest exchanges

[5] 47 U.S.C. §272.

[6] *LEC Classification Order, supra,* 12 FCC Rcd. 15756 at ¶170.

to much smaller independent ILECs in the last four years. For example, Valor was created in 1999 in order to purchase many of GTE's smallest exchanges in Texas, New Mexico and Oklahoma. Spectra Communications likewise was formed in 1999 to acquire 107 of GTE's smallest exchanges in Missouri. Citizens Communications has acquired 110 GTE exchanges in Illinois serving an average of 1,000 loops each, and CenturyTel has purchased 105 small GTE exchanges in Arkansas.

Even if the largest ILECs had not sold many of their smallest exchanges to much smaller ILECs within the last four years, independent ILEC exchanges still would be more widely dispersed than BOC exchanges today than in 1997 since some BOCs in the last four years have acquired ILECs with large service areas that adjoin the acquiring BOCs' service territory. For example, four months after the FCC's 1997 order adopting Rule 64.1903, Bell Atlantic expanded its already large and dense exchange service area in the mid-Atlantic states by acquiring NYNEX, which had an equally large and dense service area adjoining the Bell Atlantic territory. Last year, moreover, Bell Atlantic added to the density of its service area by acquiring several thousand GTE exchanges, including all GTE exchanges in Virginia and Pennsylvania.

The second factor that caused the Commission in 1997 to reject proposals to apply the BOC separations requirements to independent ILECs was the agency's conclusion that independent ILECs as a group are less likely than BOC-ILECs to engage in predatory conduct against in-region interexchange competitors because the service area of independent ILECs as a group is more rural than the service area of BOC-ILECs.[7] The service area of independent ILECs as a group is even more rural today than in 1997 when compared with the service area of BOC-ILECs. For example, 1328 ILECs have fewer than 100,000 access lines today whereas 1309 ILECs had fewer than 100,000 access lines in 1997.[8] Similarly, 47 ILECs have between

[7] *Id.*

[8] Calculated from data contained in USTA's "Phone Facts" for 1997 and for 2001.

20,000 and 50,000 access lines today whereas 41 ILECs had between 20,000 and 50,000 access lines in 1997.[9]

The Commission's 1997 conclusion that an independent ILEC is less likely than a BOC-owned ILEC to engage in predatory behavior against in-region interexchange competitors because a smaller percentage of independent ILEC in-region interexchange traffic terminates within originating ILEC exchange areas likewise provides an even stronger basis for reaching that same conclusion today.[10] This is because it is plain that an even smaller percentage of independent ILEC originating interexchange traffic terminates today in that same ILEC's exchange area than in 1997 given that independent ILECs operate smaller and geographically more dispersed exchanges today than in 1997 as indicated above.

The FCC's 1997 finding that the absence of any substantiated complaints of predatory conduct by independent ILECs against in-region interexchange competitors further supports the rejection of proposals to impose the BOC separations requirements on independent ILECs today.[11] This is because in the more than four years since that finding, few complaints have been filed against independent ILECs alleging discrimination against interexchange competitors and even fewer, if any, have been substantiated.

Not only is the risk of predation by an independent ILEC less today than in 1997 for the four reasons discussed above, more harm would result from imposing the more stringent BOC exchange/interexchange separations requirements on independent ILECs today than would have occurred if those requirements had been imposed in 1997. Imposing the more stringent requirements in 1997 would have forced an independent ILEC to provide in-region interexchange service more inefficiently than is possible in the absence of the requirements as

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[9] *Id.*

[10] *LEC Classification Order, supra,* 12 FCC Rcd. 15756 at ¶ 170.

[11] *Id.* at ¶165.

the FCC acknowledged at the time,[12] and these operating inefficiencies would have resulted in a smaller profit margin for the ILEC's interexchange business. Imposing the more stringent requirements today, by contrast, could cause many independent ILECs, including Valor, to exit the interexchange market altogether. This is because there now is almost no room to reduce profit margins on interexchange service further since margins today are razor thin due to increasingly intense interexchange price competition since 1997. This phenomenon of declining profit margins in the interexchange service business is discussed below in more detail on page 10.

II. In Fact, the Public Interest Now Requires that the FCC Repeal Rule 64.1903 and Rely Instead on Other Existing Telecommunications Policies Designed to Help Prevent Predatory Conduct

While there is no basis for increasing the exchange/interexchange separations requirements presently imposed by Rule 64.1903 on independent ILECs, there are three reasons why repealing that Rule is required. We discuss each reason below.

A. The FCC's Decision to Repeal an Identical Rule in a Directly Analogous Situation Requires Repeal of Section 64.1903

First, the FCC's decision to repeal Section 20.20 of the Rules requires that it repeal Section 64.1903 as well. Rule 20.20 was adopted shortly after Section 64.1903 was promulgated. It requires that ILECs structurally separate their exchange service and commercial mobile radio service ("CMRS") operations in the same way that Rule 64.1903 requires separation of exchange and interexchange operations. The Commission had adopted Section 20.20 for precisely the same reasons that it earlier had held Section 64.1903 to be necessary.[13] However, whereas Section 20.20 expires on January 1, 2002, Rule 64.1903 continues in force until it is repealed. Since the Commission had justified both rules based on identical factual

[12]LEC Classification Order, *Second Order on Recon., supra*, 16 Comm. Reg. 507 at ¶ 18.

[13] *CMRS Safeguards Order*, 12 FCC Rcd. 15668 (1997), *recon.* 14 FCC Rcd. 11343 (1999), *further recon.* 15 FCC Rcd. 414 (1999).

assumptions, termination of the exchange/CMRS separations rule on January 1, 2002 eliminates any conceivable justification for retaining the exchange/interexchange separations rule beyond that date.

B. Recent Changes in Regulatory Policy Have Reduced the Risk of Predation

Regulatory policy changes referred to in USTA's comments also justify repeal of Section 64.1903 since they have reduced the risk of predatory conduct by independent ILECs. Standardization of both the technical specifications for interstate access arrangements as well as the procedures by which ILECs provide those arrangements likewise reduce the risk that an independent ILEC might engage in discriminatory provision of interstate access if Rule 64.1903 were repealed. When the rule was adopted in early 1997, some independent ILECs still offered technologically different forms of interstate access to different interexchange service providers pursuant to waivers of the requirement to offer technologically identical access to all interexchange providers.[14] But those waivers have now expired, and several new equal access requirements have been implemented as well.[15]

C. The Cost of Complying With Rule 64.1903 Now Exceeds the Benefit Even If Regulatory Policy Changes Had Not Reduced the Risk

Even if regulatory policy changes had not reduced the risk that independent ILECs could harm interexchange competition if Rule 64.1903 were repealed, that rule still should be repealed since the dampening effect it now has on interexchange competition outweighs the risk of predatory conduct harming interexchange competition. In 1998, the FCC acknowledged that Rule 64.1903 imposes legal and administrative costs on any ILEC that provides in-region interexchange service, but it dismissed the significance of those costs because

[14] *See MTS and WATS Market Structure*, 100 FCC 2d 860 (1985) (adopting requirement that independent ILECs provide "equal access" to interexchange carriers within three years of the date that an interexchange carrier requests equal access).

[15] *See, e.g., Order on Recon. in CC Dkt. 92-237*, FCC 97-386 (rel. Oct. 22, 1997) (requiring all switched access providers to eliminate three digit CICs as of June 3, 1998); *Implem. Of the Subscriber Carrier Selection Change Provisions of the Telecom. Act of 1996, Second Report and Order*, 14 FCC Rcd. 1508 (1998), *recon.* 15 FCC Rcd. 8158 (2000), *further recon.* 15 FCC Rcd. 15996 (2000) (adopting new rules prohibiting carriers from changing the interexchange carrier to which an end user is subscribed without that end user's authorization).

of its assumptions that (i) only insignificant costs are imposed by the rule when an ILEC provides interexchange service on a resale basis, and (ii) independent ILECs are content to provide interexchange service on that basis.[16] Even if those assumptions were accurate two years ago, they are not accurate today. First, the legal and administrative costs imposed by Rule 64.1903 when an ILEC provides interexchange service on a resale basis are not insignificant as USTA explains in its comments and as the USTA member survey attached to those comments confirms. But even if the cost to comply with Rule 64.1903 were insignificant when an ILEC provides interexchange service on a resale basis, many independent ILECs are no longer content to provide interexchange service on a resale basis. This is because rapidly growing competition in the interexchange market within the past two years has increased the desire of many independent ILECs to convert their in-region interexchange resale operations to facilities-based operations in order to give them a greater ability to increase profit margins by lowering operating costs and by differentiating their interexchange services from those offered by competitors. In order to remain competitive today, an interexchange carrier must either reduce operating costs or differentiate its interexchange products from those of other carriers. A carrier that provides interexchange service on a resale basis has less ability to reduce operating costs than a carrier providing interexchange service on a facilities-basis since fewer parties supply the inputs to a service provided by a reseller than to service provided by a facilities-based carrier. A carrier that provides interexchange service on a resale basis also has less ability to differentiate its products than a carrier providing interexchange service on a facilities-basis since a reseller merely resells service that was developed and packaged by the carrier whose service it resells whereas a facilities-based carrier is able more easily to differentiate its interexchange products through deployment of its own network infrastructure.

[16] *LEC Classification Order, Second Order on Recon., supra*, 16 Comm. Reg. 507 at ¶ 18.

The development of exchange competition in the period since Rule 64.1903 was adopted also reduces the risk that independent ILECs would engage in predatory conduct against their interexchange competitors if the rule were repealed. Independent ILECs, including Valor, face far more exchange competition now than when the rule was adopted. Even in areas where significant exchange competition has yet to develop, the fact that the FCC and state public utility commissions have established detailed regulatory requirements since Rule 64.1903 was adopted to facilitate the development of such competition also helps reduce the risk of predatory behavior.

CONCLUSION

The FCC should not increase the separations requirements applicable to independent ILECs that provide interexchange service in their exchange areas. Instead, the agency should eliminate the existing requirements which are set forth in Rule 64.1903 and rely instead on other existing regulatory policies that are designed to help prevent the type of predatory conduct that Rule 64.1903 itself is designed to prevent.

Respectfully submitted,

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